

period to a calendar year and effects the change by filing a return for a short period ending on December 31, 1964. Dividend credits for the short period beginning on March 1 and ending on December 31, 1964, are as follows:

Period with respect to which earned	Date credited in 1964	Amt.
January-March 1964 .....	Mar. 31	\$250,000
April-June 1964 .....	June 30	300,000
July-September 1964 .....	Sept. 30	300,000
October-December 1964 .....	Dec. 31	350,000
Total dividends credited ....		1,200,000

Since the change of accounting period results in amounts of dividends credited (\$1,200,000) representing periods totaling 12 months (January through December 1964), and such periods represent more than the number of months (10) in the short period, an amount shall not be allowed as a deduction in such short period which is in excess of \$1,000,000, which is the amount which bears the same ratio to the amount of dividends credited in the short period (\$1,200,000) as the number of months (10) in the short period bears to the number of months (12) with respect to which such dividends are credited. Thus, \$200,000 (\$1,200,000 minus \$1,000,000) is not allowed as a deduction in the short period.

(3) *When amounts allowable.* The amount of dividends or interest not allowed as a deduction under subparagraph (1) of this paragraph shall be allowed as follows (subject to the limitation that the total of the amounts so allowed shall not exceed the amount not allowed under subparagraph (1)):

(i) Such amount shall be allowed as a deduction in a later taxable year or years subject to the limitation that, when taken together with the deductions otherwise allowable in the later taxable year or years, it does not bring the deductions for any later taxable year to a total representing a period of more than 12 months (or number of months in the short period, if applicable). However, in any event, an amount otherwise allowable under subdivision (ii) of this subparagraph shall be allowed notwithstanding the fact that it may bring the deductions allowable to a total representing a period of more than 12 months (or number of months in the short period, if applicable).

(ii) In any case in which it is established to the satisfaction of the Commissioner that the taxpayer does not intend to avoid taxes, one-tenth of such amount shall be allowed as a de-

duction in each of the 10 succeeding taxable years—

(a) Commencing with the taxable year for which such amount is not allowed as a deduction under subparagraph (1), or

(b) In the case of such amount not allowed for a taxable year ending before July 1, 1964, commencing with either the first or second taxable year after the taxable year for which such amount is not allowed as a deduction under subparagraph (1) if the taxpayer has not taken a deduction on his return, or filed a claim for credit or refund, in respect of such amount under (a).

Normally, if the deduction not allowed under subparagraph (1) is a result of a change, not requested by the taxpayer, in the taxpayer's annual accounting period or dividend or interest payment or crediting dates solely as a consequence of a requirement of a Federal or State regulatory authority, or if the deduction is not allowed solely as a result of the taxpayer being a party to an acquisition to which section 381(a) applies, the Commissioner will permit the allowance of the amount not allowed in the manner provided in this subdivision. Nothing set forth in this subdivision shall be construed as permitting the allowance of a credit or refund for any year which is barred by the limitations on credit or refund provided by section 6511.

(iii) If the total of the amounts, if any, allowed under subdivisions (i) and (ii) of this subparagraph before the taxable year in which the taxpayer liquidates or otherwise ceases to engage in trade or business is less than the amount not allowed under subparagraph (1), there shall be allowed a deduction in such taxable year for the difference between the amount not allowed under subparagraph (1) and the amounts allowed, if any, as deductions under subdivisions (i) and (ii) unless the circumstances under which the taxpayer ceased to do business constitute an acquisition described in section 381(a) (relating to carryovers in certain corporate acquisitions). If the circumstances under which the taxpayer ceased to do business constitute an acquisition described in section 381(a), the acquiring corporation shall succeed

to and take into account the balance of the amounts not allowed on the same basis as the taxpayer, had it not ceased to engage in business.

[T.D. 6500, 25 FR 11720, Nov. 26, 1960, as amended by T.D. 6520, 25 FR 13692, Dec. 24, 1960; T.D. 6710, 29 FR 3473, Mar. 18, 1964; T.D. 6735, 29 FR 6494, May 19, 1964; T.D. 6772, 29 FR 15753, Nov. 24, 1964; T.D. 6917, 32 FR 6682, May 2, 1967; T.D. 8408, 57 FR 12420, Apr. 10, 1992; T.D. 8482, 58 FR 42233, Aug. 9, 1993; T.D. 8554, 59 FR 36360, July 18, 1994]

### § 1.461-2 Contested liabilities.

(a) *General rule*—(1) *Taxable year of deduction.* If—

(i) The taxpayer contests an asserted liability,

(ii) The taxpayer transfers money or other property to provide for the satisfaction of the asserted liability,

(iii) The contest with respect to the asserted liability exists after the time of the transfer, and

(iv) But for the fact that the asserted liability is contested, a deduction would be allowed for the taxable year of the transfer (or, in the case of an accrual method taxpayer, for an earlier taxable year for which such amount would be accruable),

then the deduction with respect to the contested amount shall be allowed for the taxable year of the transfer.

(2) *Exception.* Subparagraph (1) of this paragraph shall not apply in respect of the deduction for income, war profits, and excess profits taxes imposed by the authority of any foreign country or possession of the United States, including a tax paid in lieu of a tax on income, war profits, or excess profits otherwise generally imposed by any foreign country or by any possession of the United States.

(3) *Refunds includible in gross income.* If any portion of the contested amount which is deducted under subparagraph (1) of this paragraph for the taxable year of transfer is refunded when the contest is settled, such portion is includible in gross income except as provided in § 1.111-1, relating to recovery of certain items previously deducted or credited. Such refunded amount is includible in gross income for the taxable year of receipt, or for an earlier taxable year if properly accruable for such earlier year.

(4) *Examples.* The provisions of this paragraph are illustrated by the following examples:

*Example (1).* X Corporation, which uses an accrual method of accounting, in 1964 contests \$20 of a \$100 asserted real property tax liability but pays the entire \$100 to the taxing authority. In 1968, the contest is settled and X receives a refund of \$5. X deducts \$100 for the taxable year 1964, and includes \$5 in gross income for the taxable year 1968 (assuming § 1.111-1 does not apply to such amount). If in 1964 X pays only \$80 to the taxing authority, X deducts only \$80 for 1964. The result would be the same if X Corporation used the cash method of accounting.

*Example (2).* Y Corporation makes its return on the basis of a calendar year and uses an accrual method of accounting. Y's real property taxes are assessed and become a lien on December 1, but are not payable until March 1 of the following year. On December 10, 1964, Y contests \$20 of the \$100 asserted real property tax which was assessed and became a lien on December 1, 1964. On March 1, 1965, Y pays the entire \$100 to the taxing authority. In 1968, the contest is settled and Y receives a refund of \$5. Y deducts \$80 for the taxable year 1964, deducts \$20 for the taxable year 1965, and includes \$5 in gross income for the taxable year 1968 (assuming § 1.111-1 does not apply to such amount).

(5) *Liabilities described in paragraph (g) of § 1.461-4.* [Reserved]

(b) *Production costs*—(1) *In general; asserted liability.* For purposes of paragraph (a)(1) of this section, the term "asserted liability" means an item with respect to which, but for the existence of any contest in respect of such item, a deduction would be allowable under an accrual method of accounting. For example, a notice of a local real estate tax assessment and a bill received for services may represent asserted liabilities.

(2) *Definition of the term "contest".* Any contest which would prevent accrual of a liability under section 461(a) shall be considered to be a contest in determining whether the taxpayer satisfies paragraph (a)(1)(i) of this section. A contest arises when there is a bona fide dispute as to the proper evaluation of the law or the facts necessary to determine the existence or correctness of the amount of an asserted liability. It is not necessary to institute suit in a court of law in order to contest an asserted liability. An affirmative act denying the validity or accuracy, or both,